



ARTHURANDERSEN

## **ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM**

Combined Financial Statements  
June 30, 2000  
Together with Report of  
Independent Public Accountants

## ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Table of Contents  
June 30, 2000

	Page
Report of Independent Public Accountants	1
Combined Balance Sheet - All Fund Types and Account Groups	2
Statement of Revenues, Expenditures, and Changes in Fund Balances - All Governmental Fund Types	3
Statement of Revenues, Expenditures and Changes in Fund Balances of the General and Special Revenue Funds - Budget Basis	4
Statement of Revenues, Expenses, and Changes in Retained Earnings - Proprietary Fund	5
Statement of Cash Flows - Proprietary Fund	6
Notes to Combined Financial Statements	7
Supplementary Information:	
Exhibit I - Schedule of Expenditures of Federal Awards	16
Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	17



ARTHURANDERSEN

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Director of the  
Arizona Health Care Cost Containment System:

We have audited the accompanying combined balance sheet of the ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM (AHCCCS, an agency of the State of Arizona), as of June 30, 2000, and the related statements of (1) revenues, expenditures and changes in fund balances - all governmental fund types; (2) revenues, expenditures and changes in fund balances of the General and Special Revenue Funds - budget basis; (3) revenues, expenses and changes in retained earnings - proprietary fund; and (4) cash flows - proprietary fund, for the year then ended. These financial statements are the responsibility of AHCCCS' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards (1994 Revision)*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AHCCCS as of June 30, 2000, and the results of its operations and the cash flows of its proprietary fund for the year then ended in conformity with accounting principles generally accepted in the United States.

Our audit was performed for the purpose of forming an opinion on the basic financial statements of AHCCCS taken as a whole. The accompanying schedule of expenditures of Federal awards (Exhibit I) is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 25, 2000, on our consideration of AHCCCS' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

*Arthur Andersen LLP*

Phoenix, Arizona  
August 25, 2000

**ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM**

Combined Balance Sheet - All Fund Types and Account Groups  
June 30, 2000  
(Amounts in Thousands)

	Governmental Fund Types		Proprietary Fund	Account Groups		
	General Fund	Special Revenue Fund	Enterprise Fund	General Fixed Assets Account Group	General Long-Term Liability Account Group	Totals (Memorandum Only)
<u>Assets</u>						
Cash and Investments	\$ 20,271	\$ 217,797	\$ 5,645	\$ -	\$ -	\$ 243,713
Due from State and County Governments	37,908	1,809	-	-	-	39,717
Due from the Federal Government, net	119,735	-	-	-	-	119,735
Receivables and Other	301	4,663	2,416	-	-	7,380
Furniture and Equipment	-	-	29	8,248	-	8,277
Amount to be Provided for Retirement of General Long-Term Liabilities	-	-	-	-	2,094	2,094
Total assets	<u>\$ 178,215</u>	<u>\$ 224,269</u>	<u>\$ 8,090</u>	<u>\$ 8,248</u>	<u>\$ 2,094</u>	<u>\$ 420,916</u>
<u>Liabilities and Fund Equity</u>						
Bank Overdraft	\$ 430	\$ -	\$ -	\$ -	\$ -	\$ 430
Accounts Payable	2,623	355	-	-	-	2,978
Other Accrued Liabilities	3,604	21	23	-	-	3,648
Deferred Revenue	432	-	2,705	-	-	3,137
Due to Other Funds	227	2,393	-	-	-	2,620
Due to Federal, State and County Governments	15,503	1,540	-	-	-	17,043
Accrued Programmatic Costs	155,396	393	2,393	-	-	158,182
Accrued Vacation Benefits	-	-	-	-	2,094	2,094
Total liabilities	<u>178,215</u>	<u>4,702</u>	<u>5,121</u>	<u>-</u>	<u>2,094</u>	<u>190,132</u>
Contingencies						
Fund Equity:						
Net investment in fixed assets	-	-	-	8,248	-	8,248
Retained earnings	-	-	2,969	-	-	2,969
Fund balances	-	219,567	-	-	-	219,567
Total fund equity	<u>-</u>	<u>219,567</u>	<u>2,969</u>	<u>8,248</u>	<u>-</u>	<u>230,784</u>
Total liabilities and fund equity	<u>\$ 178,215</u>	<u>\$ 224,269</u>	<u>\$ 8,090</u>	<u>\$ 8,248</u>	<u>\$ 2,094</u>	<u>\$ 420,916</u>

The accompanying notes are an integral part of this balance sheet.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Statement of Revenues, Expenditures and Changes in Fund Balances -  
All Governmental Fund Types for the Year Ended June 30, 2000  
(Amounts in Thousands)

	General Fund	Special Revenue Fund
Revenues:		
State appropriations	\$ 526,921	\$ -
Federal government:		
Acute care	833,485	24,635
Long-term care	341,513	-
Pass through funds	340,782	-
County government:		
Acute care	66,519	-
Long-term care	145,346	-
Tobacco tax revenue	-	78,545
Miscellaneous, primarily investment income	5,298	18,862
Total revenues	<u>2,259,864</u>	<u>122,042</u>
Programmatic Expenditures:		
Capitation:		
Acute care	878,783	41,270
Long-term care	647,532	-
Mental health services	108,224	-
Fee-for-service:		
Acute care	265,489	273
Long-term care	34,433	-
Disproportionate share	111,086	-
Graduate medical education	12,623	-
Reinsurance	45,010	684
Medicare premiums:		
Acute care	26,964	-
Long-term care	10,647	-
Children's Rehabilitative Services	19,431	-
Total programmatic expenditures	<u>2,160,222</u>	<u>42,227</u>
Administrative Expenditures	109,876	10,474
Administrative Expenditures Passed Through	<u>19,399</u>	<u>-</u>
Total expenditures	<u>2,289,497</u>	<u>52,701</u>
Excess of Revenues (Under) Over Expenditures Before Transfers	(29,633)	69,341
Transfers Out:		
To General Fund	-	(30,095)
To Arizona Department of Health Services	-	(39,494)
To Health Crisis Fund	-	(29)
To Arizona Department of Economic Security	-	(553)
To Office of Administrative Hearings	-	(26)
To Healthcare Group	-	(7,031)
Transfers In:		
From Special Revenue Fund	29,483	-
From Government Information Technology Agency	<u>150</u>	<u>-</u>
Excess of Revenues Over (Under) Expenditures after Transfers	-	(7,887)
Beginning Fund Balances	<u>-</u>	<u>227,454</u>
Ending Fund Balances	<u>\$ -</u>	<u>\$ 219,567</u>

The accompanying notes are an integral part of this statement.

# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Statement of Revenues, Expenditures and Changes in Fund Balances  
of the General and Special Revenue Funds - Budget Basis For the Year Ended June 30, 2000  
(Amounts in Thousands)

	General Fund		Special Revenue Funds	
	Appropriation (Budget)	Actual	Appropriation (Budget)	Actual
				Under/(Over) Spending Authority
Revenues:				
State appropriations	\$ 870,439	\$ 516,248		\$ -
Federal government	262,868	1,216,334		25,842
Federal pass-through funds	-	330,845		-
County government	44,735	214,664		15,173
Tobacco tax revenue	26,972	-		1,296
Miscellaneous	18,290	5,724		42,311
Total revenues	142,343	2,283,815		
Other Financing Sources:				
Operating transfer in	516,432	22,076		
Total revenues and other financing sources	1,882,079	2,305,891		
Programmatic Expenditures:				
Acute capitation	\$ 870,439	\$ 870,194	\$ -	\$ -
Acute fee-for-service	262,868	240,187	52,738	29,564
Children's Health Insurance Program	-	-	-	-
Reinsurance	44,735	44,735	-	-
Medicare premiums	26,972	26,964	-	-
Graduate medical education	18,290	18,290	-	-
Disproportionate share	142,343	125,178	-	-
Long-term care	516,432	497,459	-	-
Total programmatic expenditures	1,882,079	1,823,007	52,738	29,564
Administrative Expenditures	117,315	111,107	7,806	6,218
Total appropriated expenditures	\$ 1,999,394	\$ 1,934,114	\$ 60,544	\$ 35,782
Non-Appropriated Expenditures		330,955		10,183
Revenues and Other Financing Sources Over (Under) Expenditures		40,822		(3,654)
Beginning Fund Balances (Deficit)		(20,122)		227,422
Residual Fund Balance Distribution/Transfers		(6,841)		-
Ending Fund Balances		\$ 13,859		\$ 223,768

The accompanying notes are an integral part of this statement.

## ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Statement of Revenues, Expenses and Changes in Retained Earnings - Proprietary Fund  
For the Year Ended June 30, 2000  
(Amounts in Thousands)

	Enterprise Fund
Revenues:	
Premiums	\$ 19,536
Investment income	<u>180</u>
Total revenues	<u>19,716</u>
Operating Expenses:	
Premiums paid to health plans	18,792
Reinsurance premiums	<u>7,031</u>
Total operating expenses	<u>25,823</u>
General and Administrative Expenses:	
Salaries and employee benefits	541
Professional and outside services	119
Other expenses	205
Depreciation expense	<u>10</u>
Total general and administrative expenses	<u>875</u>
Total expenses	<u>26,698</u>
Net Loss Before Transfers	(6,982)
Transfers In (Out):	
Transfer In - Special Revenue Fund	7,031
Transfer Out – Office of Administrative Hearings	<u>(14)</u>
Net Income	35
Retained Earnings, beginning of year	<u>2,934</u>
Retained Earnings, end of year	<u>\$ 2,969</u>

The accompanying notes are an integral part of this statement.

## ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Statement of Cash Flows - Proprietary Fund  
For the Year Ended June 30, 2000  
(Amounts in Thousands)

	<u>Enterprise Fund</u>
Cash Flows from Operating Activities:	
Net income	\$     35
Adjustment to reconcile net income to cash flows provided by operating activities-	
Depreciation expense	10
Changes in net assets and liabilities:	
Increase in receivables and other	(2,392)
Increase in deferred revenue	157
Increase in other accrued liabilities	<u>2,396</u>
Net cash provided by operating activities	<u>206</u>
Cash and Cash Equivalents, beginning of year	<u>5,439</u>
Cash and Cash Equivalents, end of year	<u>\$ 5,645</u>

The accompanying notes are an integral part of this statement.



## ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Notes to Combined Financial Statements

June 30, 2000

(Dollar Amounts in Thousands)

### 1. Arizona Health Care Cost Containment System Operations

The Arizona Health Care Cost Containment System (AHCCCS), an agency of the State of Arizona (State), was established by the Arizona Legislature in November 1981 to administer healthcare for the State's indigent population. AHCCCS is a State agency managed by an independent cabinet level administration created by the Arizona Legislature, and it is funded by a combination of Federal, State and county funds. The Federal portion is funded through the Health Care Financing Administration (HCFA) of the U.S. Department of Health and Human Services under a Section 1115 waiver approved by HCFA, which exempts the AHCCCS program from certain requirements of conventional Medicaid programs. This waiver has been renewed by HCFA through September 30, 2002. AHCCCS receives quarterly Federal grants from HCFA (as matching funds) to cover a portion of the healthcare costs of the residents of the State eligible for the State's Title XIX (Medicaid) and Title XXI Children's Health Insurance Program (CHIP). State appropriations and county funds are based on a yearly budget as dictated by the Arizona Legislature and specified in Arizona Session Law.

AHCCCS provides acute and long-term healthcare coverage to eligible residents of Arizona. Eligible residents include those who qualify under Section 1931(b) of the Social Security Act, Supplemental Security Income (SSI), children who meet certain age requirements from families receiving food stamps, and children and pregnant women whose household income meets eligibility requirements. Other low income persons may qualify by meeting certain income and resource criteria as certified by the county eligibility offices.

Under AHCCCS, healthcare is provided substantially through a competitive bidding process with private and county-sponsored health plans bidding for the enrollment of AHCCCS eligibles by geographic service area. AHCCCS awards contracts to the plans for the acute and long-term care populations. In addition, AHCCCS purchases healthcare services directly from providers (see Fee-for-Service Payments in Note 2).

Other AHCCCS lines of business include the Healthcare Group, which provides prepaid medical coverage primarily to small businesses, and the Premium Sharing Program, which provides coverage to individuals who meet certain income criteria and who are not covered through other health insurance programs. See Notes 5 and 6 for more information on these programs.

### 2. Summary of Significant Accounting Policies

The accounting policies of AHCCCS conform to accounting principles generally accepted in the United States applicable to governmental units. The following is a summary of the significant accounting policies.

#### a. Basis of Presentation

The accounting system is organized and operated on a fund basis. The Account Groups and Special Revenue and Enterprise Funds are described in Notes 3, 4, 5, and 6.

The financial statements present the Governmental Funds on the modified accrual basis of accounting. The Enterprise Fund is presented on the accrual basis of accounting. See Note 6 for a description of the Enterprise Fund.

b. Revenues and Expenditures - Governmental Funds

Revenues and other financial resources are recognized in the accounting period in which they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at fiscal year end. Expenditures and other uses of financial resources are recognized when the related fund liability is incurred. Accrued programmatic costs include estimates for incurred but not reported claims (IBNR). IBNR amounts are based on estimates, and actual results may differ from such estimates. These differences are recorded in the period that they are identified.

c. Revenues and Expenses - Enterprise Fund

Revenues are recognized when they are earned and expenses are recognized when they are incurred. Premiums are due by the first day of the month preceding the month of coverage. At June 30, 2000, the deferred revenue balance was comprised of premiums paid for the months of July and August 2000.

d. Encumbrances

Encumbrance accounting, under which purchase orders, contracts and other commitments for expenditures are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary control. Total encumbrances outstanding at June 30, 2000 were \$86,824. Included in this total were programmatic encumbrances outstanding of \$82,831.

e. Cash and Investments

A portion of the cash and investments maintained by AHCCCS is held in the State of Arizona Office of the Treasurer (the Treasurer). The cash and investments are invested by the Treasurer and interest is allocated to AHCCCS on a pro rata basis. Amounts held by the Treasurer totaled \$243,520 at June 30, 2000.

In accordance with the Federal Cash Management Improvement Act guidelines, AHCCCS may only request Federal funds under specified funding techniques. These techniques require that AHCCCS draw down or request funds for any checks issued, in accordance with its historical average check clearing pattern. The timing difference that is created, due to drawing down funds over an extended time period to cover an issued check, results in bank overdrafts to AHCCCS at various times in the year. At June 30, 2000, a bank overdraft of \$430 existed which represents the excess of checks issued over funds drawn.

f. Capitation Payments

AHCCCS' contracted health plans receive fixed capitation payments, generally in advance, based on certain rates for each AHCCCS member enrolled with them. The plans are required to provide all covered healthcare services to their members, regardless of the cost of care given to them. If there are funds remaining, the plan retains the funds as profit; if the costs are higher than the amount of revenue received, the plan absorbs the loss, except for those cases eligible for reinsurance payments.

Effective October 1, 1997, AHCCCS capitated its contracted health plans for the cost of providing medical services to eligible persons from the date of eligibility to the time of enrollment with a contracted health plan. This period is referred to as prior period coverage (PPC) and was historically covered by AHCCCS on a fee-for-service basis. Effective October 1, 1999, AHCCCS reimburses the health plans for the amount actual PPC medical expenses exceed capitation and reinsurance paid. Accrued programmatic costs include approximately \$12,900 at June 30, 2000, representing estimated settlements payable to contracted health plans for PPC. Actual results may differ from this estimate.

g. Reinsurance Payments

AHCCCS provides a stop-loss reinsurance program for its contracted health plans for partial reimbursement of covered inpatient facility medical services incurred for members with an acute medical condition. For long-term care members, the program includes a deductible, which varies based on the health plans' member enrollment and the eligibility category of their members. For acute care members, prior to October 1, 1998, the program included a deductible, which varied based on the health plans' enrollment. Effective October 1, 1998, acute care health plans were allowed to choose their deductible level. The deductible choice applies to all eligibility groups, except the Medically Needy/Medically Indigent (MN/MI). AHCCCS reimburses the health plans based on a coinsurance amount for inpatient covered services incurred above the deductible.

The reinsurance program also includes a special catastrophic reinsurance program, which covers conditions such as hemophilia or those conditions resulting in a covered organ transplantation. There is no deductible for catastrophic reinsurance cases, and AHCCCS reimburses the health plans at a percentage of the health plans' adjusted billed charges. Finally, the reinsurance program provides coverage for the PPC time period. PPC cases are reimbursed at 100% after the deductible of \$5,000 is met. This deductible level applies to all health plans. See Note 2f for more information on PPC.

h. Fee-for-Service Payments

The AHCCCS program is responsible for the cost of providing medical services, on a fee-for-service basis, to four populations: persons enrolled in the Emergency Services Program (ESP), prior quarter coverage for members enrolled in a health plan, persons enrolled in a health plan for less than 30 days, and Native American members enrolled with Indian Health Services (IHS). The ESP provides for emergency medical care to persons who are ineligible for full AHCCCS coverage due to their lack of U.S. citizenship or lawful alienage status. Prior quarter coverage relates to the 90-day period prior to the first day of application of a member. AHCCCS covers any unpaid bills during this period for members who would have been eligible for coverage for some period of time in that 90-day period.

Prior to the change to PPC capitation described above, the AHCCCS fee-for-service program was responsible for the cost of providing medical services to eligible persons from the date of eligibility to the time of enrollment with a contracted health plan. Effective October 1, 1997, AHCCCS' responsibility for fee-for-service coverage is limited to persons enrolled in a health plan less than 30 days.

Outpatient medical services for the ESP, prior quarter coverage and for members enrolled in a health plan for less than 30 days are reimbursed at capped fee-for-service rates based on the category of service provided. Inpatient medical services, for these populations, are reimbursed based upon an inpatient per diem reimbursement rate system.

Medical services provided at an IHS facility or by a tribal owned facility licensed by IHS are reimbursed at rates determined by HCFA. Off reservation services are reimbursed based on the AHCCCS inpatient and outpatient fee-for-service rates.

i. Disproportionate Share Hospital Payments

During 2000, HCFA and the Arizona Legislature authorized AHCCCS to pay up to \$124,892 to hospitals, which had provided care to a disproportionate share (as defined) of the State's indigent population. Also included in this total are amounts paid to certain qualifying counties having a population of 500,000 persons or less. Expenditures for disproportionate share totaled \$111,086 for the year ended June 30, 2000.

j. Taxes

AHCCCS is an agency of the State of Arizona and is not subject to income taxes.

k. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at June 30, 2000, and the reported amounts of revenues and expenditures during the fiscal year then ended. Actual results could differ from those estimates.

3. General Fixed Assets

Furniture and equipment purchases, for Governmental Fund types, are recorded as expenditures in the General Fund and Special Revenue Fund and are capitalized at acquisition cost in the General Fixed Assets Account Group. Depreciation has not been provided on general fixed assets.

Balance, June 30, 1999	\$ 8,225
Additions	1,001
Retirements	<u>(978)</u>
Balance, June 30, 2000	<u>\$ 8,248</u>

4. General Long-Term Liability

Long-term liabilities for the Governmental Fund types are recorded in the General Long-Term Liability Account Group. The General Long-Term Liability Account Group consists of employees' vested accrued vacation and accrued compensatory time benefits.

Balance, June 30, 1999	\$ 1,885
Net increase in accrued vacation and accrued compensatory time benefits	<u>209</u>
Balance, June 30, 2000	<u>\$ 2,094</u>

5. Special Revenue Fund

The Special Revenue Fund is comprised of the following:

- Medically Needy Account to provide services to the MN/MI population or to persons who cannot afford services or who would otherwise not be covered by other AHCCCS programs.
- Medical Services Stabilization Fund to offset increases in the cost of providing services to certain eligible members.
- Premium Sharing Demonstration Project Fund, which is a three-year pilot program funded from Tobacco Tax proceeds and premiums collected from participants. The pilot operates in four Arizona counties: Cochise, Maricopa, Pima and Pinal. Monies remaining in the Premium Sharing Fund on October 1, 2001, if any, revert to the Medically Needy Account.
- Third Party Liability Fund, which is comprised of monies recovered from first and third party payors under various AHCCCS recovery programs. These programs include casualty, special treatment trusts, estate and health insurance recoveries.

- KidsCare Fund, Arizona's Title XXI State Children's Health Insurance Program, provides comprehensive healthcare coverage to targeted low-income children up to the age of 19. The program is funded from Tobacco Tax proceeds and from Federal funds.
- Miscellaneous Funds that account for miscellaneous private grants and other monies received for specific purposes, including Hawaii Arizona PMMIS Alliance (HAPA), which is AHCCCS' project with Hawaii whereby AHCCCS processes the claims for Hawaii's Medicaid program. Transfers from the Special Revenue fund of \$612,000 were used to offset costs incurred by AHCCCS in connection with HAPA.

Special Revenue funds earned, expended and transferred during the fiscal year ended June 30, 2000, were as follows:

	Medically Needy Account	Medical Services Stabilization Fund	Premium Sharing Fund	Third Party Liability	KidsCare Fund	Miscellaneous Funds	Total
Fund balances, June 30, 1999	\$ 84,763	\$ 76,529	\$ 58,398	\$ 2,864	\$ 4,789	\$ 111	\$ 227,454
Receipts	78,545	-	1,385	727	24,634	4,317	109,608
Interest Earned	4,353	4,347	3,075	170	453	36	12,434
Expenditures	(805)	-	(17,275)	(670)	(30,693)	(3,258)	(52,701)
Transfers:							
Arizona Department of Health Services	(34,215)	-	-	-	(5,279)	-	(39,494)
Premium Sharing Fund	(400)	-	400	-	-	-	-
General Fund	(29,983)	-	-	-	-	(112)	(30,095)
Health Crisis Fund	(29)	-	-	-	-	-	(29)
Arizona Department of Economic Security	(500)	-	-	-	(53)	-	(553)
Children's Health Insurance Program (KidsCare)	(15,172)	-	-	-	15,172	-	-
Office of Administrative Hearings	-	-	-	-	(26)	-	(26)
Healthcare Group	-	(7,031)	-	-	-	-	(7,031)
Fund balances, June 30, 2000	<u>\$ 86,557</u>	<u>\$ 73,845</u>	<u>\$ 45,983</u>	<u>\$ 3,091</u>	<u>\$ 8,997</u>	<u>\$ 1,094</u>	<u>\$ 219,567</u>

#### 6. Enterprise Fund

The Healthcare Group was established in 1988 by the State of Arizona to administer prepaid medical coverage primarily to small uninsured businesses with 2-50 employees and employees of political subdivisions. Healthcare Group Administration (HCGA) contracts with the existing network of the AHCCCS-funded health plans to enroll members and provide healthcare services. HCGA conducts premium billing, collections and fund disbursement, data analysis and is responsible for the regulatory oversight of the health plans.

For State fiscal year 2000, the Arizona Legislature authorized an appropriation of \$8 million from the Medical Services Stabilization Fund for Healthcare Group, to be allocated among Healthcare Group health plans based on the budget projections of the plans, with reconciliation of the funds at year-end. As of June 30, 2000, the health plans had received approximately \$4.6 million of this allocation. The additional amount payable to the plans as of June 30, 2000, is estimated to be \$2.4 million and is included in the accompanying financial statements. In State fiscal year 2001, the appropriation continues through funding received from the Tobacco Settlement Fund.

7. Retirement Plan

AHCCCS employees, as defined, are covered by a defined benefit retirement plan administered by the Arizona State Retirement System Board. Benefits are established by state statute and provide retirement and long-term disability benefits to AHCCCS employees. The retirement plan is funded by payroll deductions from eligible employees' gross wages and matching amounts contributed by AHCCCS. These amounts satisfy the statutory requirement that employee and AHCCCS contributions must cover the actuarially determined current service costs of the retirement plan, plus amortization over a 30-year period of the unfunded past service liability. Payroll deductions as a percentage of employee wages were 2.17% for retirement and 0.49% for long-term disability for 2000. The matching amount contributed to the retirement plan by AHCCCS was \$764 in 2000 and is reflected as administrative expenditures in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances - all Governmental Fund Types.

Retirement benefit payments are obligations of the retirement plan and not AHCCCS. Actuarial and financial data on the retirement plan are available from the retirement plan's separately issued Comprehensive Annual Financial Report (CAFR).

8. Budgetary Basis of Accounting

The agency financial statements of AHCCCS are prepared in conformity with accounting principles generally accepted in the United States (GAAP basis). AHCCCS, like all other State of Arizona agencies, prepares its annual budget on a basis which differs from the GAAP basis. The accompanying Statement of Revenues, Expenditures and Changes in Fund Balance of the General and Special Revenue Funds - Budget Basis, presents comparisons of the legally adopted budget with actual data on a budgetary basis. Budget amounts are not presented for revenues as the State does not have a legally adopted budget for revenues. The following is a reconciliation of the GAAP basis financial statements to the budget basis for the year ended June 30, 2000:

	General Fund Actual	Special Revenue Funds Actual
Budgetary Basis Fund Balance, June 30, 2000	\$ 13,859	\$ 223,768
Basis of Accounting Differences:		
Increases to Fund Balance:		
Due from State and county governments	35,830	4
Due from the Federal government	119,735	-
Receivables and other	723	28
Total increases	156,288	32
Decreases to Fund Balance:		
Bank overdraft	(430)	-
Accounts payable	(12)	(31)
Other accrued liabilities	(831)	-
Deferred revenue	(432)	-
Due to other funds	(227)	(2,393)
Due to State and county governments	(15,503)	(1,540)
Accrued programmatic costs	(152,712)	(269)
Total decreases	(170,147)	(4,233)
Total GAAP Basis Fund Balance, June 30, 2000	\$ -	\$ 219,567

9. Contingencies

a. Grant Adjustments

Amounts received from HCFA are subject to audit and adjustment. Any claims of disallowed Federal funds drawn would constitute a liability of AHCCCS. Subsequent to year-end, HCFA indicated that it intends to disallow certain skilled professional medical personnel (SPMP) claims that it has deferred to this point. These SPMP claims relate to an agreement with the Arizona School Health Insurance Program (ASHIP - see Note 11). The disallowance of these amounts will not create a liability to the State or to AHCCCS, as AHCCCS claimed the amounts on its Form HCFA-64's but did not draw down or disburse the amounts to ASHIP.

At June 30, 2000, AHCCCS had claimed reimbursement from HCFA on its Form HCFA-64 in the amount of approximately \$28 million, representing additional reimbursement, AHCCCS believes the amount is due for healthcare services provided to Native Americans off the reservation. HCFA has deferred reimbursement of this amount as of June 30, 2000. As a result, AHCCCS has not drawn down these funds from HCFA nor are they included in the accompanying financial statements. AHCCCS believes reimbursement of these funds is supported in law and intends to vigorously pursue recovery of these funds. There were no other pending disallowances of Federal funds drawn as of June 30, 2000.

b. Litigation and Investigations

AHCCCS has been named as a defendant in a variety of litigation, all of which are being defended by legal counsel. AHCCCS is also subject to investigations by various Federal regulatory bodies. It is the opinion of AHCCCS, upon consultation with legal counsel, that none of these claims or investigations is likely to have a material adverse affect on AHCCCS' financial statements. In addition, AHCCCS believes that the funding of any material adverse judgment, sanction or repayment obligation in excess of its appropriation would require a special appropriation by the State.

c. Compliance with Laws and Regulations

AHCCCS is subject to numerous laws, regulations and oversight by the Federal government. These laws and regulations include, but are not necessarily limited to, matters such as, government healthcare program participation requirements, reimbursement for member services and Medicaid fraud and abuse. Government activity continues with respect to investigations and allegations concerning possible violations of fraud and abuse of statutes and regulations. Violations of these laws and regulations could result in expulsion from government healthcare programs, together with the imposition of significant financial sanctions. Management believes that AHCCCS is in compliance with fraud and abuse laws and regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown or unasserted at this time.

10. Transactions with Other State Agencies

AHCCCS contracts for administrative and programmatic services from other state agencies. Charges for administrative services are based on the performing agencies' actual cost. Charges for programmatic services are generally based on actuarially determined capitation rates. The following is a summary of contracted services provided.

a. Administrative Services

The State of Arizona's Department of Economic Security (DES) charges AHCCCS to determine eligibility for certain Title XIX members. The State's Department of Administration (DOA) charges AHCCCS for data center services and equipment costs. The State's Department of Health Services (DHS) charges

AHCCCS for licensure and preadmission screening and resident review (PASARR) services. These expenditures are included in administrative expenditures in the accompanying Statement of Revenues, Expenditures, and Changes in Fund Balances - All Governmental Fund Types. The following is a summary of transactions with these State agencies for the services described above for the year ended June 30, 2000.

	<u>Expenditures</u>	<u>Due to Other State Agencies</u>
Department of Economic Security	\$ 40,424	\$ 3,861
Department of Administration	5,676	-
Department of Health Services	<u>1,004</u>	<u>-</u>
	<u>\$ 47,104</u>	<u>\$ 3,861</u>

b. Programmatic Services

Certain healthcare-related programmatic services are provided by other State agencies, which include DES and DHS. AHCCCS receives the Federal funds for these services and transfers them to the appropriate agencies. The total amount of Federal funds received by AHCCCS and passed through to these agencies was \$321,383 in 2000 (including \$493, which is included in capitation-mental health and Children's Rehabilitative Services (CRS)). The amount passed through to DES totaled \$193,728 in 2000 and is classified as long-term care capitation programmatic expenditures in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental Fund Types. The other pass-through expenditures totaling \$127,655 are classified as capitation-mental health and CRS.

Revenues include \$211,865 from Arizona counties during fiscal 2000. To the extent expenditures for long-term care services are less than county and state revenues, AHCCCS is required to remit such amounts equally to the State of Arizona and the counties. At June 30, 2000, AHCCCS has accrued \$4.8 million, payable 50% to the State and 50% to the counties, relating to the amount county and state revenues will exceed related expenditures. This amount is included in the due to state and county governments in the accompanying balance sheet.

11. Other Administrative Pass Through

Arizona school districts are eligible for Federal matching funds for the administrative functions related to Early and Periodic Screening, Diagnosis and Treatment (EPSDT) outreach services at the school level. The school districts contract with AHCCCS, through ASHIP, to obtain these Federal funds. The total amount of Federal funds received by AHCCCS and passed through to ASHIP was \$16,345 in 2000. The counties are also eligible for Federal matching funds for administrative functions relating to certain eligibility determinations. The counties contract with AHCCCS to obtain these Federal funds. The total amount passed through to the counties in 2000 was \$3,031. Approximately \$23 was passed through to DHS in connection with an agreement between DHS and the Federal Department of Health and Human Services. These amounts are classified as administrative expenditures passed through in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental Fund Types.



12. New Pronouncements

There are three new Government Accounting Standards Board (GASB) pronouncements that affect AHCCCS' financial reporting:

- GASB Statement No. 33 - *Accounting and Financial Reporting for Nonexchange Transactions*: This statement establishes accounting and financial reporting standards for financial or capital nonexchange transactions, e.g. receipt of Federal grant funding. This statement is effective for periods beginning after June 15, 2000 (AHCCCS fiscal year 2001).
- GASB Statement No. 34 - *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*: This statement modifies the requirements for the basic financial statements of governments and governmental agencies to include Management's Discussion and Analysis (MD&A), which introduces the basic financial statements and provides an analytical overview of the financial activities. Required supplementary information will also be required to include budgetary comparison schedules. This statement is effective for AHCCCS for its fiscal year beginning after June 15, 2001 (AHCCCS fiscal year 2002).
- GASB Statement No. 35 - *Recipient Reporting for Certain Shared Nonexchange Revenues*: This statement removes the exception to the accounting and financial reporting requirements of Statement No. 33 for government-mandated and voluntary non-exchange transactions. This statement should be implemented simultaneously with Statement No. 33.

**EXHIBIT I****ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM**

Schedule of Expenditures of Federal Awards  
For the Year Ended June 30, 2000  
(Amounts in Thousands)

	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
<b>U.S. Department of Health and Human Services</b>		
Health Care Financing Administration		
Medicaid Program (Title XIX)	93.779	
Federal funds expended to vendors		\$ 1,174,998
Federal funds expended to subrecipients		<u>340,782</u>
		1,515,780
 State Children's Health Insurance Program (Title XXI)	 93.767	 24,302
 Maternal and Child Health Bureau		
Healthy Start South Phoenix Project	93.926B	<u>333</u>
 Total expenditures of Federal awards		 <u>\$ 1,540,415</u>

**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Director of the  
Arizona Health Care Cost Containment System:

We have audited the financial statements of the ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM (AHCCCS, an agency of the State of Arizona), as of and for the year ended June 30, 2000 and have issued our report thereon dated August 25, 2000. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards (1994 Revision)*, issued by the Comptroller General of the United States.

***Compliance***

As part of obtaining reasonable assurance about whether AHCCCS' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

***Internal Control Over Financial Reporting***

In planning and performing our audit, we considered AHCCCS' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A *material weakness* is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted certain other matters that we have communicated to management of AHCCCS in a separate letter dated August 25, 2000.

This report is intended solely for the information and use of the management of AHCCCS and the State of Arizona Auditor General and is not intended to be and should not be used by anyone other than these specified parties.



Phoenix, Arizona  
August 25, 2000